

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
ASHER AND MATILDA PIZANTE)

Appearances:

For Appellants: Archibald M. Mull, Jr., and
Millard Smith, Attorneys at Law

For Respondent: F. Edward Caine, Senior Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on protests to proposed assessments of additional personal income tax against Asher Pizante in the amount of \$3,381.80 for the year 1951, against Matilda Pizante in the amount of \$3,381.80 for the year 1951, and against Asher and Matilda Pizante in the amounts of \$14,373.06, \$14,356.12, \$11,994.08 and \$11,501.66 for the years 1952, 1953, 1954 and 1955, respectively,

Appellant Asher Pizante conducted a coin machine business in the Vallejo area under the name Pizante Amusement Company. The business owned multiple-odd bingo pinball machines, flipper pinball machines, music machines and miscellaneous amusement machines. The equipment was placed in about sixty locations such as bars and restaurants, and the proceeds from each machine, after exclusion of expenses claimed by the location owner in connection with the operation of the machine, were divided equally between Pizante Music Company and the location owner. In addition, the business made retail sales of phonograph records which had been used in the music machines and were still serviceable but no longer popular.

The gross income reported in tax returns included the total of amounts retained from locations. Deductions were taken for depreciation, salaries, phonograph records and other business expenses. Respondent determined that appellant was renting space in the locations where his machines were placed and that all the coins deposited in the machines constituted gross income to him. Respondent also disallowed all expenses pursuant to section 17297 (17359 prior to June 6, 1955) of the Revenue and Taxation Code which reads:

Appeal of Asher and Matilda Pizante

In computing taxable income, no deductions shall be allowed to any taxpayer on any of his gross income derived from illegal activities as defined in Chapters 9, 10 or 10.5 of Title 9 of Part 1 of the Penal Code of California; nor shall any deductions be allowed to any taxpayer on any of his gross income derived from any other activities which tend to promote or to further, or are connected or associated with, such illegal activities.

The evidence indicates that the operating arrangements between appellant and each location owner were the same as those considered by us in Appeal of Hall, Cal, St, Bd. of Equal., Dec. 29, 1958, 2 CCH Cal, Tax Cas. Par, 201-197, 3 P-H State & Local Tax Serv. Cal, Par, 58145, Our conclusion in Hall that the machine owner and each location owner were engaged in a joint venture in the operation of these machines is, accordingly, applicable here.

In Appeal of Advance Automatic Sales Co., Cal, St, Bd. of Equal., Oct. 9, 1952, 3 CCH Cal, Tax Cas. Par, _____, 2 P-H State & Local Tax Serv. Cal, Par, 13288, we held the ownership or possession of a pinball machine to be illegal under Penal Code sections 330b, 330.1, and 330.5 if the machine was predominantly a game of chance or if cash was paid to players for unplayed free games, and we also held bingo pinball machines to be predominantly games of chance.

Three location owners testified that they generally paid cash to players of the pinball machines for unplayed free games, one location owner testified that he made similar payments except in the form of merchandise instead of cash. An employee of Pizante Music Company testified that it was the general practice for location owners to claim substantial amounts from the proceeds of the machines for expenses, that he assumed the location owners were making payouts for free games and that he had seen them make such payouts. There were introduced in evidence copies of four collection reports which have indications of payouts or expenses with respect to the pinball machines, We conclude that it was the general practice to pay cash to players of pinball machines owned by Pizante Music Company for unplayed free games, Accordingly, the bingo pinball machine phase of the business was illegal both on the ground of ownership and possession of bingo pinball machines which were predominantly games of chance and on the ground that cash was paid to winning players. Respondent was therefore correct in applying section 17297.

Appeal of Asher and Matilda Pizante

The Pizante Music Company was operated as an integrated business*. A collector would collect from any type of machine being used in the business, and a mechanic would repair any type of machine being used in the business. Approximately half of the locations serviced by the company had both a music machine and a bingo pinball machine. We conclude that the legal operation of music and amusement machines was connected or associated in a substantial way with the illegal operation of bingo pinball machines and respondent was therefore correct in disallowing all the expenses of the business*.

There were not complete records of amounts paid to winning players on the bingo pinball machines and respondent estimated such amounts as equal to 50 percent of the total amounts deposited in such machines. At the time of the audit in 1957, respondent's auditor interviewed 11 location owners who had bingo pinball machines from Pizante Music Company. Of the 11, four stated that payouts for free games were not made and seven stated that such payouts were made. Of the seven, one could give no estimate of the percentage of payouts and of the other six, one gave an estimate of 17 percent, two of 20 percent, one of 33-1/3 percent, one of 50 to 55 percent and one of 50 to 60 percent. The 50 percent estimate used by respondent was based on the result of these interviews and on the experience of the auditor in investigating other pinball machine operators.

Of the four location-owner witnesses who appeared at the hearing on this appeal, two were unable to give any estimates of the percentage of the payouts. One of the location owners estimated the payouts at 60 percent of the total proceeds of the machine. Another location owner estimated the payouts at 20 percent of the total proceeds of the pinball and music machines combined. As to this latter witness, we do not know the relative proportions of the income contributed by the pinball and the music machines in his location. His payout estimate with reference to the proceeds of the pinball machines can probably be taken as equivalent to somewhere between 30 and 50 percent of the proceeds of the pinball machines. The four collection reports received in evidence indicate an over-all payout percentage of 42 percent.

We conclude that respondent's estimate of payouts should be reduced to 40 percent of the amounts deposited in the bingo pinball machines,

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of Asher and Matilda Pizante

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax board on protests to proposed assessments of additional personal income tax against Asher Pizante in the amount of \$3,381.80 for the year 1951, against Matilda Pizante in the amount of \$3,381.80 for the year 1951 and against Asher and Matilda Pizante in the amounts of \$14,373.06, \$14,356.12, \$11,994.08 and \$11,501.66 for the years 1952, 1953, 1954 and 1955, respectively, be modified in that the gross income is to be recomputed in accordance with the opinion of the board. In all other respects the action of the Franchise Tax Board is sustained.

Done at Pasadena, California, this 27th day of November, 1962, by the State Board of Equalization,

<u>George R. Reilly</u>	, Chairman
<u>Richard Nevins</u>	, Member
<u>Paul R. Leake</u>	, Member
<u>John W. Lynch</u>	, Member
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ATTEST: Dixwell L. Pierce, Secretary